

Operation of a separately incorporated thrift shop to raise funds for a group of specified exempt organizations may qualify for exemption under section 501(c)(3) of the Code; Revenue Ruling 68-439 revoked.

Internal Revenue Service has given further consideration to Revenue Ruling 68-439, C.B. 1968-2, 239. The question concerns the application of section 502 of the Internal Revenue Code of 1954, prior to its amendment by the Tax Reform Act of 1969, Public Law 91-172, C.B. 1969-3, 10, to an organization that operated a thrift shop where substantially all of the goods had been donated and more than half of the work was performed without compensation, under the circumstances described below.

X, a nonprofit organization, operated a thrift shop. X was organized by a group of nonprofit organizations described in section 501(c)(3) of the Code and all of X's profits were payable to these organizations. Substantially all of the merchandise sold by X had been contributed and more than half of the work in operating the thrift shop was performed without compensation. Paid employees were reasonably compensated for their services.

Section 502 of the Code provides that an organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under section 501 on the ground that all of its profits are payable to one or more organizations exempt under section 501.

Had the activity described above been carried on directly by any one of the exempt organizations, any profit therefrom would have been excluded from taxation under section 511 of the Code by the provisions of section 513(a)(3) of the Code. X was organized as a separate corporation to operate the thrift shop in order to insulate the assets of the exempt organizations from any potential liability arising out of the operations of the thrift shop and to enable X to have a separate governing body and organizational structure composed of persons interested in aiding the exempt organizations principally through volunteer work in connection with the operation of the thrift shop.

The primary purpose for which X was operated was to serve the group of exempt organizations by performing an essential function for them; that is, to solicit contributions of goods on behalf of the exempt organizations and to convert the contributed goods to cash for charitable uses with a minimum of expense by the use of volunteer labor. X was organized as a separate corporation only to secure the organizational advantages described above.

Accordingly, it is held that X is not precluded from qualification for exemption under section 501 of the Code by section 502 of the Code prior to its amendment by the Tax Reform Act of 1969. X may qualify as an organization described in

section 501(c)(3) of the Code, if it otherwise meets the requirements of that section.

For taxable years beginning after December 31, 1969, section 502(b)(2) of the Code, added by section 121(b)(7) of the Tax Reform Act of 1969, permits the exemption of certain thrift shops.

Revenue Ruling 68-439, which held that the operation of a separately incorporated thrift shop to raise funds for a specific charitable organization constitutes a trade or business within the meaning of section 502 of the Code, and accordingly precludes exemption of such a thrift shop under section 501(c)(3), is hereby revoked.